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DOW THEORY LETTERS, INC.

"The Market as Interpreted under the Dow Theory"

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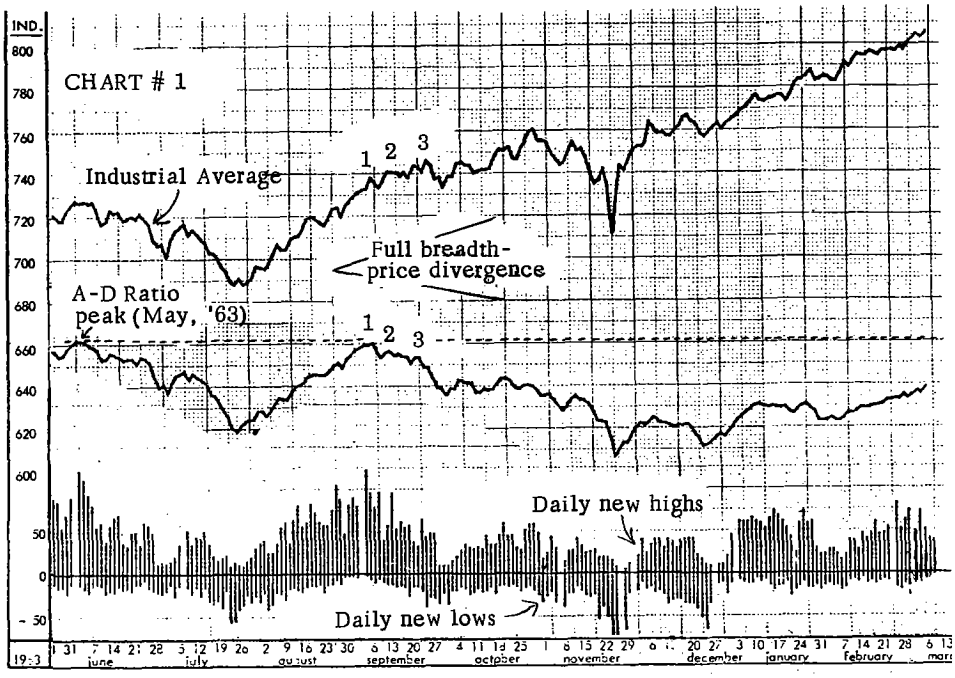
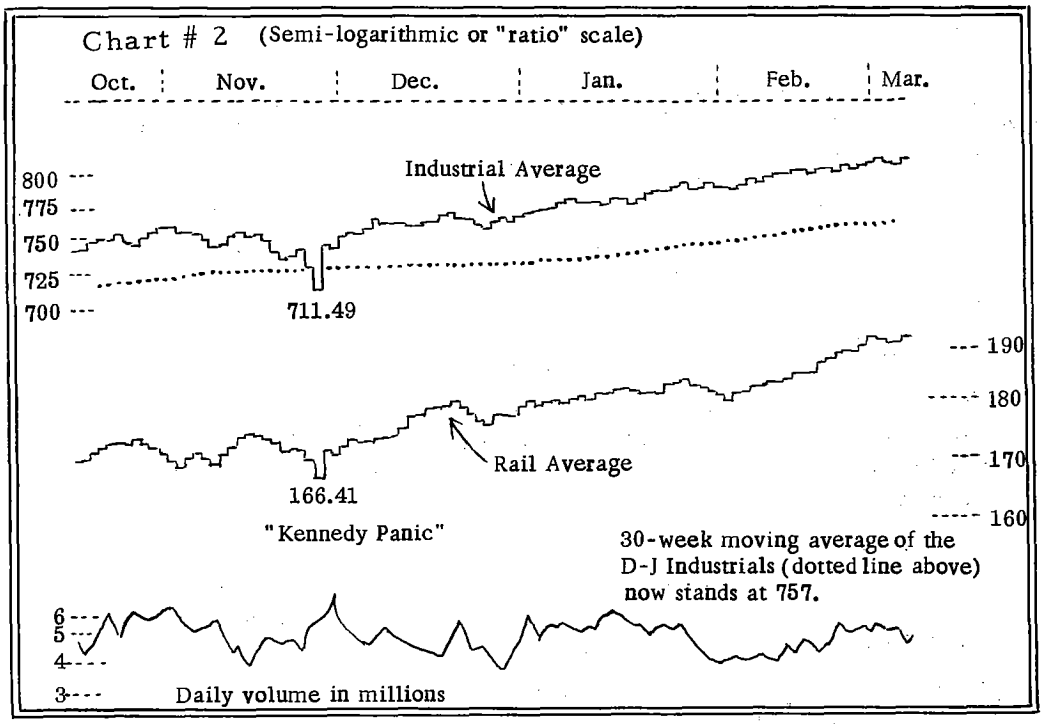
THE MARKET: Except for the trifling 7¢ decline during the week ending December 13, the Industrial Average has pushed higher in every one of the past fourteen weeks. The nearest thing to this performance in the history of the Averages was the eleven-week Industrial advance which took place between March 8 and May 17, 1963.

So persistent and uncorrected has the advance been that even the most bullish of the bulls are now warning vaguely of "a minor correction ahead."

But the Averages act as if they had "a rendezvous with destiny". Higher and higher the structure rises — like a circus performer who has become hypnotized by the very "impossibility" of his own act. Hamilton once remarked that before a bull market ends, "the edifice of speculation has to be constructed sufficiently high for it to make 'a noise' when it topples over." The Averages seem intent upon building just this type of structure.



It is notable that the rise in the Averages continues (see Chart 1) with the advance-decline ratio still unable to better the previous peaks of September and May, 1963. The advance has also failed to bring in any significant expansion in daily new highs or volume. Ten months have now elapsed since the A-D ratio "topped out" in May, 1963. This equals the longest such time lag in the record (the previous longest span was the ten month lag between the March, 1959, peak in the A-D ratio and the final high recorded by the Industrial Average in January, 1960).



1959-64: With few exceptions, the best and most informative writing about the stock market has been done in retrospect — often long after the event. Rare is the analyst who is brilliant enough (or lucky enough) to see "the big picture" as the market story actually unfolds. There have been a few great "on-the-scene" analyses, however. Hamilton wrote a series of remarkable pieces in 1921. During that year he forecast the beginning of what was to be one of the most fantastic bull markets in history. Eight years later in his famous "Turn of the Tide" editorial

 (Wall Street Journal, October 23, 1929), Hamilton predicted the great bull market's doom. On November 12, 1932, Robert Rhea wrote the first Letter of his investment service. In that report he presented evidence (then considered sensational) to prove his thesis that history's worst bear market was over. Five years later Rhea turned bearish prior to the disastrous crash of 1937.

I have before me a piece written by a veteran Dow Theorist, Justin Barbour (printed in the Chicago Journal of Commerce, July 6, 1942). Here Barbour presents a supurb and absolutely correct line of reasoning in an effort to prove that the long, depressing bear market of 1939-42 was over and that a new bull market had started. Many Dow Theorists "called" the 1946 bear market, but on June 18, 1949, E. George Schaeffer (in what I felt was an outstanding analysis) correctly predicted the birth of a new bull market. On that day he wrote: "In the past 17 years only three opportunities presented themselves to buy stocks at great values, and now the fourth opportunity is making its appearance."

But what of the rise since 1949? It has in many ways been the most difficult that this writer has ever seen or studied. But why, one asks, is this one any more difficult than any other? Is it simply because we are now living through it? In my opinion, the difficult thing about this market is that in lasting so long it has done practically everything, and in doing everything it has caused everybody to be partly wrong.

In 1953 and again in 1957 Dow Theory "bear signals" were given, but the Averages subsequently recovered and pushed to new highs. In early 1960 another bear market signal was given, and here many analysts (who had been wrong earlier) stepped forth to proclaim that the 1960 bear signal was "a false one". I, for one, believed that the 1960 bear signal was valid, particularly since the bull market had (during 1958-59) experienced a speculative "third phase" for the first time since 1945-46. A drastic decline occurred during 1960, but despite subsequent new highs in the Averages, the majority of stocks never did succeed in climbing above their 1959 peaks. In retrospect I believe that there is a good case for saying that the main upward momentum of the post-war bull market ended in 1959. It was in that year (March) that the advance-decline ratio "topped out" (at a level slightly below its 1956 high but still close enough to be labeled a "double top"). Then, in April, 1959, Barron's Low-Priced Stock Index topped out together with many other more important issues. The public was heavily committed in 1959, and for the most part they never recouped their investments in the "high flyers" of that year.

Following the 1960 decline, another recovery got underway. It was during this recovery (1961) that the so-called "glamour stocks" made their spectacular appearances together with the volatile "new issues" (1961 witnessed the first true new issues market since 1945-46). In 1961 a surge of speculation occurred on the Amex, and for a few weeks volume on the Amex actually gave N.Y.S.E. volume a run for its money. But the party came to an end with the crash of 1962, and during that year most of the glamour stocks, the Amex stocks and the 1961 new issue stocks lost anywhere from 20% to 90% of their value. As this is written, such big names of 1961 as Fairchild, Beckman, Brunswick, Raytheon, Automatic Canteen, Varian, etc. have shown no signs of recovering.

And so we come to 1962-64. The current advance has (so far) been a "blue-chip" move — a rise of the investment-grade issues. In many ways, 1962-64 has been the most complex of all the upward thrusts since 1959. The current rise has progressed without benefit of any "new issues"; it has not spurred any noticeable activity on the American Exchange; it has not "rubbed off" on the over-the-counter market; it has not affected the low-priced issues (Barron's Low-Priced Stock Index is now 180 against 250 in 1959); it has continued for the past ten months without an advancing trend in the majority of stocks on the N.Y.S.E.

But there is one point which should be emphasized. In 1959 it was the majority of stocks and most particularly the low-priced stocks which topped out. Nevertheless, in the subsequent 1960 decline the Industrial Average did not sustain severe damage. In 1962 it was the Amex issues, the over-the-counter issues, the "glamour stocks" and the "new issues" which collapsed. But even in 1962 the Industrial Average (although it violated the halfway level of the entire 1957-61 rise) avoided a shattering break of the type seen in 1937 or 1929 (in other words, a drop of 50% or more).

And now, during 1963-64 it is again the Industrial Average which is surging to new highs (with solid technical aid from the Rails). As I review the events of 1959 to the present I cannot help but ask: "Are we finally seeing the classic 'blue-chip blow-off'? Is this the counterpart of 1929, when the two Averages surged higher and higher into the rarefied atmosphere of 'overvaluation-land'?" A well-known Wall Street trader once told me: "All great bull and bear markets die the same way — in utter exhaustion." As one studies the action of the current market, one cannot help wondering if this is not the final relentless rise, the movement which will end only in complete "exhaustion" and a collapse of the Averages themselves.

Has the great "fooler" of 1959-64 been that it has required three upward thrusts to distribute the equities of the post-war bull market? Have the "perpetual bulls" been tricked because the majority of stocks have already turned down? Or have the "early bears" been fooled by the fact that the Averages have risen to new highs while many stocks have also staged remarkable recoveries.

Perhaps the final words on the subject were penned by the great analyst and Editor of Forbes Magazine, Richard Schabacker. Looking back on the 1929 fiasco, he wrote: "Able forecasters had been bearish for over a year. They had been wrong so long that no one heeded or respected their bearish warnings. In such circumstances the bearish side was logical, for it was the "unpopular view." ("Stock Market Profits," Schabacker, 1934).

SUNDRY COMMENTS: U.S. Governmental fiscal policy made history on February 27, 1964, with the passage of the $11 billion tax cut. The Federal Reserve Act of 1914 allowed the Federal Reserve system to raise or lower interest rates and to expand or

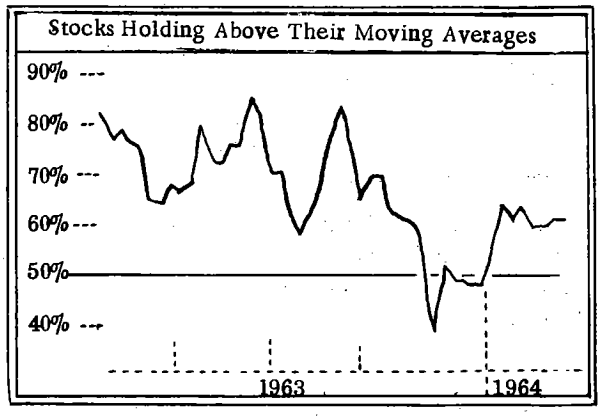
contract the supply of money. Thus, the original concept was that of "leaning against the wind" — or raising interest rates and contracting the money supply when business conditions became "too boomy" and of following the opposite procedure when business required monetary encouragement.

A major change of philosophy came with the passage of the Employment Act of 1946. From that point on, Government was charged with the actual task of maintaining prosperity. As Burton Crane in his book, "The Sophisticated Investor" says" "If a slump appears, the Government is now obliged by law to provide cheap money, tax reductions, Federal spending and whatever other devices are necessary to make the wheels of business turn a little faster."

But the tax reduction of 1964 represents a concept in fiscal-political thinking which carries far beyond the Employment Act of 1946. For now, amid record Federal debts, amid record Government spending, with the Fed's Production Index at a record high, taxes have been cut and the President of the United States himself encourages the nation's citizens to spend the increase in personal income which will be provided by the tax cut. Thus, our President has openly requested the people (regardless of their needs) to spend (not save) money which has been "manufactured" at the expense of what promises to be even greater deficits in the U.S. budget. It seems to me that this year's tax cut represents "the climax" in the long line of deficit- producing measures which the U.S. has followed since the 1930's.

Mr. Justin Barbour is a long-time market observer. In his most recent report he notes: "The all-inclusive index of excess is the degree of inflation of the public and private debt. It is such debt that creates and sustains the boom until it eventually collapses." Mr. Barbour then lists the increases in various debt catagories since 1945: Real estate credit increase since 1945...693%; Consumer credit increase...1,128%; Corporate debt increase...329%; Federal Government increase...22%; State and Municipality increase...499%. "The collapse of a single (credit) condition is likely to trigger the downturn," states Mr. Barbour.

The cost of servicing all this debt is, of course, staggering. As I see it, two possibilities could turn the debt picture into a flaring "danger signal". One, mounting interest rates and a simultaneous rise in the cost of servicing the debt. Along these lines, the recent rise to 5% in the British bank rate is worth pondering (it could easily exert an adverse effect on interest rates here). Secondly, declining revenues are always a danger within the context of a towering debt structure. The possibility of a business slow-down (declining revenues) in 1964 is considered so remote and is such a "contrary opinion" that the whole idea is worth pondering. The more so since the latest report of the Geisinger Index shows that indicator dropping to a figure of minus 2.2 for June, 1964 (this famous index enjoys a remarkable record of correctly predicting the course of the Federal Reserve Board Index of Production). A minus 2.2 for June, 1964, suggests the definite possibility of a "softening" business picture as 1964 moves along (a figure below minus 2.0 on the Geisinger Index is considered a harbinger of recession in the economy). With business and the stock market in their current state of "white heat", any unexpected change could have drastic repercussions. (Geisinger Index, 680 West End Ave., N.Y.C. 25).



STOCKS: Of 432 stocks which are tabulated weekly at this office, 276 (64%) are holding above their long-term or 30-week moving averages, an improvement of 3% from last week (this study is still bullish).

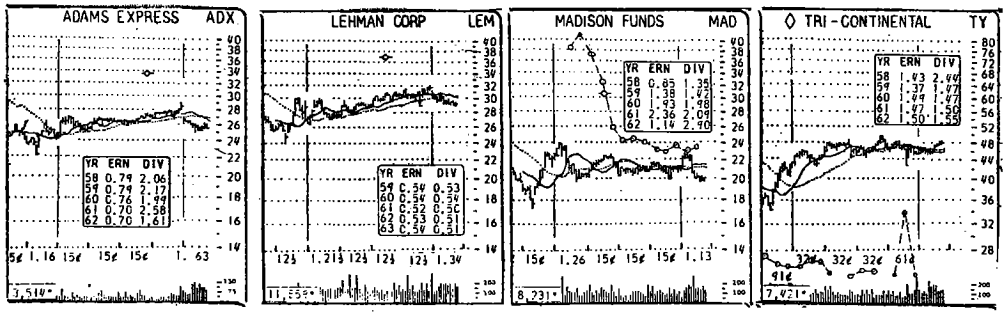
How difficult is it to pick the "winners" in this market? Here's an edifying comparison. During the rise of 1953-56, every one of the 30 stocks in the Industrial Average broke into all-time high territory. During the week ending February 29, 1964, as the Industrial Average pushed above the 800 level, only one Dow stock, International Harvestor, recorded an all-time high.

Another indication worth studying. The leading investment trusts make it a practice to use the best professional advice that money can buy. I have included charts of four leading representative trusts (page 4) — all listed on the N.Y.S.E. Also shown (below) is the 1959 high and the January-February, 1964, high on each issue (to the nearest whole number). Taken as an average, the 1964 highs on these four funds add up to only 1 point more than the 1959 highs. Since 1959 the market has obviously been no "cup of tea", even for the investment trusts.

	1959 high	1964 high
Adams Express	30	26
Lehman Corp.	32	30
Madison Fund	20	22
Tri-Continental	43	48

Note also that the four funds recorded almost all of their 1962-64 gains during the seven months following the October, 1962, lows. This corresponds with the 7 months in which the A-D ratio rose with the Averages. Conclusion: even professionals find it difficult to make money when market breadth is against them. A final significant observation: note that three out of the

four funds (all excepting TY) have lately broken below their long-term or 30-week moving averages (dotted lines on charts).



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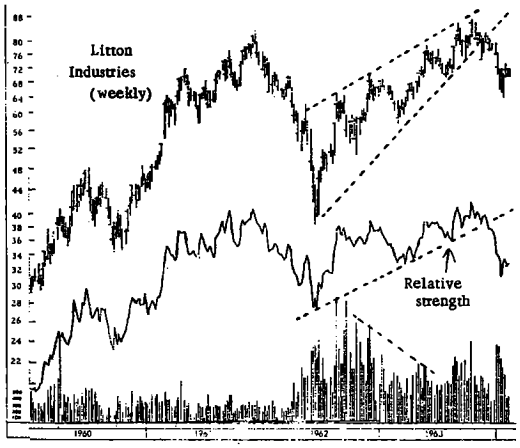
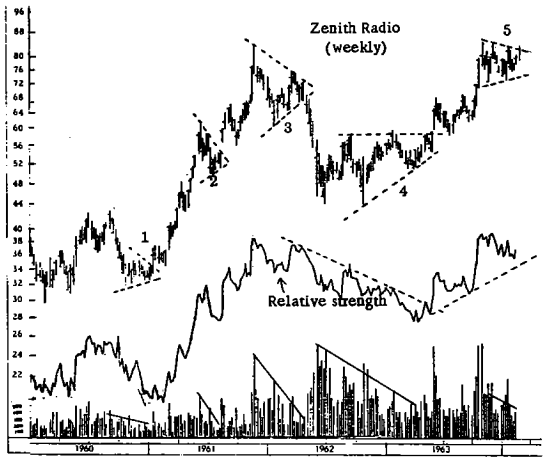
From the 1962 low, Litton Industries (see weekly chart) has traced a huge "rising wedge pattern". A rising wedge is formed by two ascending and converging trendlines, and this pattern is indicative of a situation in which buying interest is slowly diminishing (note declining volume). It is not uncommon for prices to rise to a new high within the context of a rising wedge, and this deceptive action is exactly what occurred in Litton. During the last few months, however, Litton has fallen out of the wedge, its relative strength line has broken down, and I list the stock as a short on any rally.



Zenith, on the other hand, has always been a most reliable stock. One of the characteristics of ZE is its frequent large triangles. Note triangle # 1 on the chart. This is the formation from which the entire 1960-62 rise in ZE started. A second triangle (2) formed in ZE, and this proved to be a consolidation pattern, which prepared the stock for a further upward move. Triangle # 3 was a distributive formation, and this was the pattern which gave way to the violent 1962 decline in ZE. The decline terminated with the formation of the massive ascending or right-angle triangle (# 4). Triangle 4 formed the base from which the current rise stemmed. Note that ZE has now formed another large triangle (# 5). Triangle # 5 is a symmetrical triangle like all the other triangles except # 4. The symmetrical triangle, in which the upper trendline slopes down and the lower trendline slopes up, is a pattern of indecision. Unlike the ascending triangle (# 4), which is always bullish, the symmetrical triangle gives no hint as to which way prices will eventually emerge. So — if ZE breaks up above 84-5 it is a "buy"; if it breaks down to 72 or below sell it short. The odds are that the final breakout in ZE will be both violent and valid (they usually are in ZE).



The chart below shows the 5-year decline in price and relative strength in the Rubber Group. Although the Group's price is still well below its 1959 high, its relative strength line has just reversed the long declining channel of relative strength or "popularity". Within the Group, Firestone, Goodyear and U. S. Rubber look best; Goodrich and Gen. Tire least attractive.

McDonnell Aircraft has just pushed out of what I consider to be a huge "rectangle" a formation which is comparable to a "line" in the averages. The move could take MAC to 76 or the height of the rectangle (12 points) added to the point of breakout (60 plus 12). This "measurement" or "count" from a rectangle breakout is usually quite accurate. I consider MAC to be a good speculation.

Chart # 1 and charts of ZE, LIT, and MAC courtesy of Traders Research, 1431 Pearl Avenue, Alton, Illinois 62003. Charts of the four investment trusts on this page courtesy of Quote Digest, 110 North Lorraine, Wichita, Kansas.